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Demand for Apartments Proves Stronger Than Thought, Driven by Millennials

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Good news for multifamily housing—demand for space is likely to be even stronger than experts estimated, helping the sector keep ahead of new construction for the immediate future, according to the *Mid-Year Outlook 2104* from Freddie Mac Multifamily Research.

"For a majority of the markets... new supply will continue to be absorbed as it enters the market and rents will continue to rise," the agency's researchers note.

Apartment pros have been increasingly worried about overbuilding as the rate of new apartment construction approaches its old historical average. In 2013, starts of multifamily properties with five or more units reached 295,000 unites, on par with the average from 1995-2007. In the first half of 2014, starts exceeded the average by about 50,000 units.

Demand is likely to be stronger than that historical average, however. Freddie Mac's economists now say that demand for rental apartments will average 440,000 units a year over the next 10 years.

"There has been a shortfall of housing formation due to the recession," says Steve Guggenmo, senior director of multifamily research and modeling with Freddie Mac. Freddie Mac counts 3.9 million households that should have formed in the U.S., but didn't during the recession and slow recovery period. These people are still likely to form households eventually, but for now are living at home or have gone back to university. Three-quarters of those involved are young people under the age of 34.

Homebound

That's a prime demographic for multifamily landlords. When they do form households of their own, Freddie Mac estimates that 1.7 million of them will choose to live in multifamily rental properties. Simply taking these young people into account would increase the demand for rental housing by more then one hundred units a year over the next 10 years.

"This is purely people out there coming into households, as they have in the past," says Guggenmo.

These new renters are likely to rent apartments after they have found employment. That means that, as usual, new demand will focus around employment centers and be realized as the job market continues to improve.

Other housing market watchers, including the Joint Center for Housing Studies at Harvard University and the economists at the Kansas City Federal Reserve, expect a similar amount of pent-up demand for apartments, says Guggenmo.

"Demographic forces alone would lift the number of renter households by 4.0-4.7 million in 2013-23," according to the Joint Center for Housing Studies.

These new households may already be entering the market. That's one of the reasons vacancies continue to be low, even though new apartments are coming on the market.

"In the beginning of the year, as the rate of completions got close to 300,000-a-year, people were expecting some moderation to the average vacancy rate," says Guggenmo. That didn't happen. Instead vacancy rates have continued to fall."

Eventually, all of the people who have waited to form households will do so. Once they have, the demand for apartments should fall back to historic averages, barring some other variable changes in the equation. For example, Millennials may prove to be more likely to rent apartments than to buy single-family homes, Guggenmo says. A change of just a percentage point in the homeownership rate could have a large effect on the demand for apartments.

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